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payment and calculated under specified prepayment assumptions.

(1) *You* means a Farm Credit bank, association, or service corporation.

[64 FR 28895, May 28, 1999, as amended at 70 FR 51589, Aug. 31, 2005]

EFFECTIVE DATE NOTE: At 77 FR 66370, Nov. 5, 2012, §615.5131 was amended by removing designations for paragraphs (a) through (l) and maintaining alphabetical order; removing the reference to “615.5131(h)” from the definition for “asset-backed securities (ABS)” and adding in its place the words “this section”; and adding in alphabetical order definitions for “government agency” and “government-sponsored agency”, effective 30 days after publication in the FEDERAL REGISTER during which either or both Houses of Congress are in session. For the convenience of the user, the added text is set forth as follows:

§615.5131 Definitions.

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Government agency means the United States Government or an agency, instrumentality, or corporation of the United States Government whose obligations are fully and explicitly insured or guaranteed as to the timely repayment of principal and interest by the full faith and credit of the United States Government.

Government-sponsored agency means an agency, instrumentality, or corporation chartered or established to serve public purposes specified by the United States Congress but whose obligations are not fully and explicitly insured or guaranteed by the full faith and credit of the United States Government, including but not limited to any Government-sponsored enterprise.

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§615.5132 Investment purposes.

Each Farm Credit bank is allowed to hold eligible investments, listed under §615.5140, in an amount not to exceed 35 percent of its total outstanding loans, to comply with the liquidity reserve requirement of §615.5134, manage surplus short-term funds, and manage interest rate risk under §615.5135.

[70 FR 51589, Aug. 31, 2005]

EFFECTIVE DATE NOTE: At 77 FR 66370, Nov. 5, 2012, §615.5132 was revised, effective 30 days after publication in the FEDERAL REGISTER during which either or both Houses of Congress are in session. For the convenience of

the user, the revised text is set forth as follows:

§615.5132 Investment purposes.

(a) Each Farm Credit bank may hold eligible investments, listed under §615.5140, in an amount not to exceed 35 percent of its total outstanding loans, to comply with its liquidity requirements in §615.5134, manage surplus short-term funds, and manage interest rate risk under §615.5180. To comply with this calculation, the 30-day average daily balance of investments is divided by loans. Investments are calculated at amortized cost. Loans are calculated as defined in §615.5131. For the purpose of this calculation, loans include accrued interest and do not include any allowance for loan loss adjustments. Compliance with the calculation is measured on the last day of every month.

(b) The following investments may be excluded when calculating the amount of eligible investments held by the Farm Credit bank pursuant to §615.5132(a):

(1) Eligible investments listed under §615.5140 that are pledged by a Farm Credit bank to meet margin requirements for derivative transactions; and

(2) Any other investments FCA determines are appropriate for exclusion.

§615.5133 Investment management.

(a) *Responsibilities of Board of Directors.* Your board must adopt written policies for managing your investment activities. Your board of directors must also ensure that management complies with these policies and that appropriate internal controls are in place to prevent loss. Annually, the board of directors must review these investment policies and make any changes that are needed.

(b) *Investment policies.* Your board’s written investment policies must address the purposes and objectives of investments, risk tolerance, delegations of authority, and reporting requirements. Investment policies must be appropriate for the size, types, and risk characteristics of your investments.

(c) *Risk tolerance.* Your investment policies must establish risk limits and diversification requirements for the various classes of eligible investments and for the entire investment portfolio. These policies must ensure that you maintain appropriate diversification of your investment portfolio. Risk limits must be based on your institutional objectives, capital position, and risk tolerance. Your policies must identify the

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types and quantity of investments that you will hold to achieve your objectives and control credit, market, liquidity, and operational risks. The policy of any association or service corporation that holds significant investments and each bank must establish risk limits for the following four types of risk.

(1) *Credit risk.* Investment policies must establish:

(i) Credit quality standards, limits on counterparty risk, and risk diversification standards that limit concentrations based on a single or related counterparty(ies), a geographical area, industries or obligations with similar characteristics.

(ii) Criteria for selecting brokers, dealers, and investment bankers (collectively, securities firms). You must buy and sell eligible investments with more than one securities firm. As part of your annual review of your investment policies, your board of directors must review the criteria for selecting securities firms and determine whether to continue your existing relationships with them.

(iii) Collateral margin requirements on repurchase agreements.

(2) *Market risk.* Investment policies must set market risk limits for specific types of investments, the investment portfolio, or your institution. Your board of directors must establish market risk limits in accordance with these regulations and our other policies.

(3) *Liquidity risk.* Investment policies must describe the liquidity characteristics of eligible investments that you will hold to meet your liquidity needs and institutional objectives.

(4) *Operational risk.* Investment policies must address operational risks, including delegations of authority and internal controls in accordance with paragraphs (d) and (e) of this section.

(d) *Delegation of authority.* All delegations of authority to specified personnel or committees must state the extent of management's authority and responsibilities for investments.

(e) *Internal controls.* You must:

(1) Establish appropriate internal controls to detect and prevent loss, fraud, embezzlement, conflicts of interest, and unauthorized investments.

(2) Establish and maintain a separation of duties and supervision between personnel who execute investment transactions and personnel who approve, reevaluate, and oversee investments.

(3) Maintain management information systems that are appropriate for the level and complexity of your investment activities.

(f) *Securities valuation.* (1) Before you purchase a security, you must evaluate its credit quality and its price sensitivity to changes in market interest rates. You must also verify the value of a security that you plan to purchase, other than a new issue, with a source that is independent of the broker, dealer, counterparty or other intermediary to the transaction.

(2) You must determine the fair market value of each security in your portfolio and the fair market value of your whole investment portfolio at least monthly. You must also evaluate the credit quality and price sensitivity to change in market interest rates of all investments that you hold on an ongoing basis.

(3) Before you sell a security, you must verify its value with a source that is independent of the broker, dealer, counterparty, or other intermediary to the transaction.

(g) *Reports to the board.* Each quarter, management must report to the board of directors or a board committee on the performance and risk of each class of investments and the entire investment portfolio. These reports must identify all gains and losses that you incur during the quarter on individual securities that you sold before maturity. Reports must also identify potential risk exposure to changes in market interest rates and other factors that may affect the value of your bank's investment holdings. Management's report must discuss how investments affect your bank's overall financial condition and must evaluate whether the performance of the investment portfolio effectively achieves the board's objectives. Any deviations from the board's policies must be specifically identified in the report.

[64 FR 28895, May 28, 1999]

EFFECTIVE DATE NOTE: At 77 FR 66371, Nov. 5, 2012, §615.5133 was revised, effective 30 days

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after publication in the FEDERAL REGISTER during which either or both Houses of Congress are in session. For the convenience of the user, the revised text is set forth as follows:

§ 615.5133 Investment management.

(a) *Responsibilities of board of directors.* Your board of directors must adopt written policies for managing your investment activities. Your board must also ensure that management complies with these policies and that appropriate internal controls are in place to prevent loss. At least annually, the board, or a designated committee of the board, must review the sufficiency of these investment policies. Any changes to the policies must be adopted by the board and be documented.

(b) *Investment policies—general requirements.* Your board's written investment policies must address the purposes and objectives of investments; risk tolerance; delegations of authority; internal controls; due diligence; and reporting requirements. Moreover, your investment policies must fully address the extent of pre-purchase analysis that management must perform for various classes of investments. Furthermore, your investment policies must address the means for reporting, and approvals needed for, exceptions to established policies. Investment policies must be sufficiently detailed, consistent with, and appropriate for the amounts, types, and risk characteristics of your investments.

(c) *Investment policies—risk tolerance.* Your investment policies must establish risk limits for the various types, classes, and sectors of eligible investments and for the entire investment portfolio. These policies must include concentration limits to ensure prudent diversification of credit, market, and liquidity risks in the investment portfolio. Risk limits must be based on all relevant factors, including your institutional objectives, capital position, earnings, and quality and reliability of risk management systems and must take into consideration the interest rate risk management program required by § 615.5180 or § 615.5182, as applicable. Your policies must identify the types and quantity of investments that you will hold to achieve your objectives and control credit, market, liquidity, and operational risks. Each association or service corporation that holds significant investments and each bank must establish risk limits in its investment policies for these four types of risk.

(1) *Credit risk.* Investment policies must establish:

(i) *Credit quality standards, limits on counterparty risk, and risk diversification standards that limit concentrations.* Limits must be set for single or related counterparty(ies), a geographical area, in-

dustries, and asset classes or obligations with similar characteristics.

(ii) *Criteria for selecting brokers, dealers, and investment bankers (collectively, securities firms).* You must buy and sell eligible investments with more than one securities firm. As part of your review of your investment policies required under paragraph (a) of this section, your board of directors, or a designated committee of the board, must review the criteria for selecting securities firms. Any changes to the criteria must be approved by the board.

(iii) *Collateral margin requirements on repurchase agreements.* You must regularly mark the collateral to market and ensure appropriate controls are maintained over collateral held.

(2) *Market risk.* Investment policies must set market risk limits for specific types of investments and for the investment portfolio.

(3) *Liquidity risk.* Investment policies must describe the liquidity characteristics of eligible investments that you will hold to meet your liquidity needs and other institutional objectives.

(4) *Operational risk.* Investment policies must address operational risks, including delegations of authority and internal controls in accordance with paragraphs (d) and (e) of this section.

(d) *Delegation of authority.* All delegations of authority to specified personnel or committees must state the extent of management's authority and responsibilities for investments.

(e) *Internal controls.* You must:

(1) Establish appropriate internal controls to detect and prevent loss, fraud, embezzlement, conflicts of interest, and unauthorized investments.

(2) Establish and maintain a separation of duties between personnel who supervise or execute investment transactions and personnel who supervise or engage in all other investment-related functions.

(3) Maintain records and management information systems that are appropriate for the level and complexity of your investment activities.

(4) Implement an effective internal audit program to review, at least annually, your investment management function, controls, processes, and compliance with FCA regulations. The scope of the annual review must be appropriate for the size, risk and complexity of the investment portfolio.

(f) *Due diligence—(1) Pre-purchase analysis.*

(i) *Eligibility, purpose, and compliance with investment policies.* Before you purchase an investment, you must conduct sufficient due diligence to determine whether it is eligible under § 615.5140, is for an authorized purpose under § 615.5132 or § 615.5142, as applicable, and complies with your board's investment

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policies. You must document your assessment and the information used in your assessment. Your board must approve your decision to hold an investment that does not comply with your investment policies.

(i) *Valuation.* Prior to purchase, you must verify the value of the investment (unless it is a new issue) with a source that is independent of the broker, dealer, counterparty or other intermediary to the transaction.

(iii) *Risk assessment.* Your assessment of each investment at the time of purchase must at a minimum include an evaluation of credit risk, liquidity risk, market risk, interest rate risk, and the underlying collateral of the investment. This assessment must be commensurate with the complexity and risk in the investment. You must perform stress testing on any investment that is structured or that has uncertain cash flows, including all mortgage-backed securities and asset-backed securities, before you purchase it. The stress test must be commensurate with the risk and complexity of the investment and must enable you to determine that the investment does not expose your capital, earnings, or liquidity to risks that are greater than those specified in your investment policies. The stress testing must comply with the requirements in paragraph (f)(4)(ii) of this section.

(2) *Ongoing value determination.* At least monthly, you must determine the fair market value of each investment in your portfolio and the fair market value of your whole investment portfolio.

(3) *Ongoing analysis of credit risk.* You must establish and maintain processes to monitor and evaluate changes in the credit quality of each investment in your portfolio and in your whole investment portfolio on an ongoing basis.

(4) *Quarterly stress testing.* (i) You must stress test your entire investment portfolio, including stress tests of all investments individually and stress tests of the portfolio as a whole, at the end of each quarter. The stress tests must enable you to determine that your investment securities, both individually and on a portfolio-wide basis, do not expose your capital, earnings, or liquidity to risks that exceed the risk tolerance specified in your investment policies. If your portfolio risk exceeds your investment policy limits, you must develop a plan to comply with those limits.

(ii) Your stress tests must be defined in a board-approved policy and must include defined parameters for the types of securities you purchase. The stress tests must be comprehensive and appropriate for the risk profile of your institution. At a minimum, the stress tests must be able to measure the price sensitivity of investments over a range of possible interest rate/yield curve scenarios. The methodology that you use to analyze investment securities must be appro-

priate for the complexity, structure, and cash flows of the investments in your portfolio. You must rely to the maximum extent practicable on verifiable information to support all your assumptions, including prepayment and interest rate volatility assumptions, when you apply your stress tests. You must document the basis for all assumptions that you use to evaluate the security and its underlying collateral. You must also document all subsequent changes in your assumptions.

(5) *Presale value verification.* Before you sell an investment, you must verify its value with a source that is independent of the broker, dealer, counterparty, or other intermediary to the transaction.

(g) *Reports to the board of directors.* At least quarterly, your management must report on the following to your board of directors or a designated board committee:

(1) Plans and strategies for achieving the board's objectives for the investment portfolio;

(2) Whether the investment portfolio effectively achieves the board's objectives;

(3) The current composition, quality, and liquidity profile of the investment portfolio;

(4) The performance of each class of investments and the entire investment portfolio, including all gains and losses realized during the quarter on individual investments that you sold before maturity and why they were liquidated;

(5) Potential risk exposure to changes in market interest rates as identified through quarterly stress testing and any other factors that may affect the value of your investment holdings;

(6) How investments affect your capital, earnings, and overall financial condition;

(7) Any deviations from the board's policies (must be specifically identified);

(8) The status and performance of each investment described in §615.5143(a) and (b) or that does not comply with your investment policies; including the expected effect of these investments on your capital, earnings, liquidity, and collateral position; and

(9) The terms and status of any required divestiture plan or risk reduction plan.

§615.5134 Liquidity reserve requirement.

(a) Each Farm Credit bank must maintain a liquidity reserve, discounted in accordance with paragraph (c) of this section, sufficient to fund 90 days of the principal portion of maturing obligations and other borrowings of the bank at all times. The liquidity reserve may only be funded from cash, including cash due from traded but not